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UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION

In re: Armen Janian, Debtor(s)	Case No.: 2:15-bk-25089-NB Adv. No.: 2:16-ap-01008-NB Chapter: 7 **MEMORANDUM DECISION GRANTING IN PART PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT**
Forrest Fykes, SR, et al., Plaintiff(s) v. Armen Janian, Defendant(s)	Hearing: Date: September 10, 2019 Time: 2:00 p.m. Place: Courtroom 1545 255 E. Temple Street Los Angeles, CA 90012

For the reasons set forth below, this Bankruptcy Court is granting in part Plaintiff's Motion for Summary Judgment (the "MSJ," adv. dkt. 36). The State Trial Court's judgment against Debtor/Defendant Mr. Armen Janian ("Debtor") in favor of Plaintiffs as to fraud is nondischargeable pursuant to Sections 523(a)(2)(A) and (a)(6).[1]

[1] Unless the context suggests otherwise, a "chapter" or "section" ("§") refers to the United States Bankruptcy Code, 11 U.S.C. § 101 et seq. (the "Code"), a "Rule" means the Federal Rules of Bankruptcy Procedure or other federal or local rule, and other terms have the meanings provided in the Code, Rules, and the parties' filed papers.

1. BACKGROUND

Debtor filed his voluntary chapter 7 petition on September 30, 2015. On December 21, 2015, Forrest Fykes, Sr., Valerie Fykes, Forrest Fykes, Jr., and Melissa Fykes ("Plaintiffs") filed a motion for relief from the automatic stay of Section 362(a) (the "R/S Motion," dkt. 20) seeking to continue their state court litigation against Debtor. Plaintiffs' state court complaint alleges, among other things, fraudulent misrepresentation and fraud and deceit based upon false promises in connection with a purported loan modification services by Debtor and his affiliates, which actually made matters worse and caused Plaintiffs to lose their home (the "State Court Suit," dkt. 20, Ex. A). This Court granted the R/S Motion on February 7, 2016. Dkt. 31.

Meanwhile, Plaintiffs commenced the above captioned adversary proceeding on January 1, 2016. Adv. dkt. 1. This adversary proceeding was stayed pending resolution of the State Court Suit. Adv. dkt. 3.

On September 20, 2017, the State Trial Court ruled in Plaintiffs' favor on all causes of action and awarded punitive damages. Adv. dkt. 38, p.3. Debtor filed a Notice of Appeal on November 16, 2017. *Id.* at 4. On December 23, 2018, the State Appeals Court affirmed the State Trial Court's decision. *Id.* That affirmance became final.

Briefly, the State Courts found as follows. Debtor was a California licensed real estate attorney who decided to enter the mortgage modification business. Adv. dkt. 38, Ex. D, pp. 978:10-979:2 (at PDF pp. 53-54). Prior to retaining Debtor, Plaintiffs were current on their mortgage. *Id.* at p.986:18-19 (at PDF p.61). Plaintiffs provided some money for a retainer agreement to one of Debtor's affiliated companies, and then ultimately to Debtor's firm. *Id.* at p.977:25-27 (at PDF p.52). Plaintiffs paid approximately $10,800 to Debtor and his affiliates. *Id.* at p.998:22-25 (at PDF p.73). Plaintiffs received ongoing instructions not the pay the mortgage. *Id.* at p.986:14-17 (at PDF p.61). After accepting Plaintiffs' retainer, Debtor referred Plaintiffs' matter to a non-lawyer who was not licensed to practice law in California in exchange for a referral fee.

Id. at pp.988:27-989:1 (at PDF pp.63-64). A case was filed on Plaintiffs' behalf in the Superior Court but was dismissed because of Debtor's failure to appear at a hearing on a fee waiver application. *Id.* at p.988:16-17 (at PDF p.63). Debtor failed to inform Plaintiffs that their case was dismissed. *Id.* at p.989:6-7 (at PDF p.64). Debtor also failed to inform Plaintiffs that their home was being put up for a foreclosure sale. *Id.* at p.989:11-12 (at PDF p.64).

The State Appeals Court summarized some additional facts found by the State Trial Court as follows:

> [Debtor's] professional failings were egregious. There was substantial evidence at trial that, among other things, [Plaintiffs] had been able to keep current with their mortgage payments before receiving [Debtor's business'] solicitation; [Debtor] and others at [his business] advised [Plaintiffs] to stop making payments – and even more significantly – to "ignore" notices of default and sale that would ensue from nonpayment; and [Debtor] and others at [Debtor's business] requested (unlawfully, per Civil Code section 2944.7) thousands of dollars in up-front payments. Compounding this malpractice, [Debtor] also failed to take any of the steps he promised [Plaintiffs] he would take to ensure that they would not lose their home: no lis pendens was recorded, no court appearance was made on the lawsuit fee waiver application, and [when the lawsuit that Debtor filed against various financial institutions was "voided" due to such non-appearance] no communication about the status of the voided lawsuit was initiated [nor did Debtor advise Plaintiffs of the pending foreclosure sale, and Plaintiffs only discovered that their home had been sold at a foreclosure sale through the internet, and were subsequently evicted "just before Thanksgiving"]. Moreover, because [Debtor] did nothing to prevent all of his client files from being lost, there was no evidence that [Debtor] (or anyone at [his business]) ever attempted to negotiate a loan modification with the [Plaintiffs'] lender prior to the foreclosure sale. [Adv. dkt. 38, Ex. I, pp. 5-6 *and* 18-19 (at PDF pp. 149-150 and 161-62).]

Based on these and other findings of fact, the State Trial Court entered its Judgment against Debtor and others for fraud, with actual damages, including emotional distress damages, of over $500,000.00, and punitive damages of another $500,000.00, among other things. Adv. dkt. 38, Ex. G, pp. 6:7-21 and 8:6-10 (at PDF pp. 130 and 132). Plaintiffs have now returned to this Bankruptcy Court to determine if their judgment against Debtor is nondischargeable.

On July 29, 2019, Plaintiff's filed their MSJ (adv. dkt. 36), Request for Judicial Notice (adv. dkt. 37), Declaration of Andrei Serpik in Support of their MSJ (adv. dkt. 38),

and their Statement of Undisputed Facts and Conclusions of Law (adv. dkt. 39). On August 20, 2019, Debtor filed his Opposition (adv. dkt. 41) and his Separate Statement of Genuine Issues (adv. dkt. 42). Plaintiffs filed a reply (adv. dkt. 43), which Debtor moved for this Court to strike (adv. dkt. 44). This Court orally denied Debtor's motion to strike at the above-captioned hearing, and took the MSJ under submission.

2. JURISDICTION, AUTHORITY, AND VENUE

This Bankruptcy Court has jurisdiction, and venue is proper, under 28 U.S.C. §§ 1334 and 1408. This Bankruptcy Court has the authority to enter a final judgment or order under 28 U.S.C. § 157(b)(2)(I). *See generally Stern v. Marshall*, 131 S. Ct. 2594 (2011); *In re AWTR Liquidation, Inc.*, 547 B.R. 831 (Bankr. C.D. Cal. 2016) (discussing *Stern*); *In re Deitz*, 469 B.R. 11 (9th Cir. BAP 2012) (same). Alternatively, the parties have expressly or implicitly consented to this Bankruptcy Court's entry of a final judgment or order. *See Wellness Intern. Network, Ltd. v. Sharif*, 135 S.Ct. 1932 (2015); *and see In re Pringle*, 495 B.R. 447 (9th Cir. BAP 2013). *See also* Rules 7008 & 7012(b); LBR 9013-1(c)(5)&(f)(3); Complaint (adv. dkt. 1) ¶ 1; Answer (adv. dkt. 8) *passim* (not addressing core/*Stern* issues); Status Report (adv. dkt. 11) p. 4 (item "F").

3. DISCUSSION

a. Legal Standards

(i) Summary Judgment

Summary judgment is properly granted when no genuine and disputed issues of material fact remain, and, when viewing the evidence most favorably to the non-moving party, the movant is entitled to prevail as a matter of law. *Celotex Corp. v. Catrett,* 477 U.S. 317, 322-23 (1986). But a mere "scintilla" of evidence in opposition to summary judgment is insufficient. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 251-52 (1986).

"Genuine": If one party's "version of events is so utterly discredited by the record that no reasonable jury could have believed him" summary judgment is appropriate. *Scott v. Harris,* 550 US 372, 380 (2007). But the Ninth Circuit has observed that "cases where intent is a primary issue generally are inappropriate for

summary judgment[.]" *Provenz v. Miller,* 102 F.3d 1478, 1489 (9th Cir. 1996). As the Bankruptcy Appellate Panel for the Ninth Circuit has explained: "Fraud claims, in particular, normally are so attended by factual issues (including those related to intent) that summary judgment is seldom possible." *In re Stephens,* 51 B.R. 591, 594 (9th Cir. BAP 1985).

"Material": Material facts which would preclude entry of summary judgment are those which, under applicable substantive law, could affect the outcome of the case. The substantive law will identify which facts are material. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 248 (1986). At the summary judgment stage, the court does not weigh the evidence and determine the truth of the matter, but determines whether there is a genuine issue for trial. *Id.* at 249.

Shifting burdens: The moving party bears the initial burden of showing that there is no material factual dispute. If the moving party meets its initial burden, the burden then shifts to the non-moving party to set out, by affidavits or admissible discovery material, specific facts showing a genuine issue for trial. *Celotex*, 477 U.S. at 324. The party opposing summary judgment must produce affirmative evidence that is sufficiently probative on the issue that a jury reasonably could rely on that evidence to decide the issue in his or her favor at trial. *Matsushita Elec. Indust. Co., Inc. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986). Without such evidence, there is no reason for a trial. *Celotex*, 477 U.S. at 323.

Evidence: Finally, the evidence presented by the parties must be admissible. *Orr v. Bank of Am., NT & SA*, 285 F.3d 764, 773 (9th Cir. 2002) ("A trial court can [ ] consider [only] admissible evidence in ruling on a motion for summary judgment.").

(ii) Issue Preclusion

The Supreme Court has stated that "collateral estoppel [*i.e.,* issue preclusion] principles do indeed apply in discharge exception proceedings pursuant to § 523(a)." *Grogan v. Garner*, 111 S.Ct. 654, 658 n.11 (1991). State court judgments are entitled to "full faith and credit" in federal courts. *See* 28 U.S.C. § 1738. "A bankruptcy court may

rely on the issue preclusive effect of an existing state court judgment as the basis for granting summary judgment. … In doing so, the bankruptcy court must apply the forum state's law of issue preclusion." *In re Plyam*, 530 B.R. 456, 462 (9th Cir. BAP 2015) (internal citation omitted); *see also In re Nourbakhsh*, 67, F.3d 798, 800 (9th Cir. 1995) ("The full faith and credit requirement of § 1738 compels a bankruptcy court in a § 523(a)(2)(A) nondischargeability proceeding to give collateral estoppel effect to a prior state court judgment. The bankruptcy court and the BAP properly looked to Florida state law to determine the preclusive effect of the prior default judgment" entered in Florida state court).

In California, issue preclusion applies if the following threshold requirements are met:

> First, the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding. Second, this issue must have been actually litigated in the former proceeding. Third, it must have been necessarily decided in the former proceeding. Fourth, the decision in the former proceeding must be final and on the merits. Finally, the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding. [*In re Harmon*, 250 F.3d 1240, 1245 (9th Cir. 2001) (internal citation omitted).]

If these threshold requirements are met, California courts will only apply issue preclusion "if application of preclusion furthers the public policies underlying the doctrine." *Id.* The party asserting preclusion bears the burden of establishing that the threshold requirements are met by providing "a record sufficient to reveal the controlling facts and pinpoint the exact issues litigated in the prior action." *In re Plyam*, 530 B.R. 456 at 462 (internal quotation and citation omitted).

(iii) Exceptions to Discharge – Section 523

Section 523 provides in relevant part

> (a) A discharge under section 727 … of this title does not discharge an individual debtor from any debt –
> …
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by –

> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; …
>
> …
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny; …
>
> …
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity; … [Section 523(a)(2)(A), (a)(4) & (a)(6)]

b. The State Court made factual findings that are binding on this Court

In his opposition, Debtor states that there are no factual findings of the State Trial Court on which this Court may rely to determine whether issue preclusion applies because (1) the State Trial Court did not sign the Plaintiffs' proposed statement of decision as is required by California Code of Civil Procedure ("Cal. C.C.P.") § 632 in order for it to be valid and binding, (2) the State Trial Court's oral statement of decision does not constitute findings and cannot be considered because a written statement of decision was required, and (3) the final judgment entered against Debtor sets forth no factual findings of the State Trial Court. *See* adv. dkt. 41, p.5-10. Debtor raises these arguments for the first time before this Bankruptcy Court, having failed to raise them before the State Trial Court and the State Appeals Court. *See* Adv. dkt. 43, p.2:12-15. Debtor's arguments are unpersuasive for the following reasons.

(i) Debtor's cited authority actually cuts against his argument

First, the statute cited by Debtor does not require a written statement of decision. Second, the cases cited by Debtor have been superseded by a California rule that no longer requires a signed statement of decision. Third, even if a statement of decision were required, failure to provide one was noted by the State Appeals Court but treated by it as, at most, harmless error.

More generally, as Debtor himself argues (adv. dkt. 41, p.9:26-10:2), "[i]n order to properly apply the doctrine of collateral estoppel, a bankruptcy court must look at the entire record of the prior proceeding, not just the judgment." *In re Silva*, 190 B.R. 889, 893 (9th Cir. BAP 1995). The entire record in this instance fully supports Plaintiffs' MSJ.

(A) Cal. C.C.P. § 632 does not require a written statement of decision

Debtor asserts that a written statement of decision was required. Adv. dkt. 41, p.7:26-8:4. Debtor ignores the requirement that he had to "request" a statement of decision before any was required.

Cal. C.C.P. § 632 provides in relevant part:

> … The court shall issue a statement of decision explaining the factual and legal basis for its decision as to each of the principal controverted issues at trial upon the **request** of any party appearing at the trial. …
>
> The statement of decision shall be in writing, unless the parties appearing at trial agree otherwise; however, when the trial is concluded within one calendar day or in less than 8 hours over more than one day, the statement of decision may be made orally on the record in the presence of the parties. [Cal. C.C.P. § 632 (emphasis added)]

Plaintiffs explain that Debtor did not request a statement of decision (adv. dkt. 43, p.5:12), and Debtor has not provided this Court with any evidence to the contrary. Therefore, Debtor has failed to establish that a written statement of decision was required in the State Court Suit.

(B) The cases on which Debtor relies predate the current version of California Rule of Court 3.1590, which does not require a written statement of decision to be signed

Debtor cites two cases from the 1930s, *Easterly v. Cook*, 140 Cal. App. 115 (Cal. Dist. Ct. App. 1934) and *Supple v. Luckenbach*, 12 Cal. 2d 319 (Cal. 1938), for the proposition that findings must be signed before they may be validly filed and serve as the basis for a judgment. Adv. dkt. 41, p.7:3-8. But those cases do not address whether a "request" for signed findings had been made (as required by Cal. C.C.P. § 632) and to the extent they rely on the California Rules of Court those cases have been superseded by the current version of those rules.

As explained by Plaintiffs, California Rule of Court 3.1590(l) specifies that a court must sign a written judgment but has no similar signature requirement for statements of decision. A leading treatise concludes, "[t]here is no requirement that a statement of

decision be signed by the court." *See* Rutter Group, Cal. Prac. Guide Civ. Trials & Ev. Ch. 16-E, para 16:190.7. Therefore, no signature was required on the statement of decision.

(C) Even if a signed statement of decision had been required, failure to issue one was immaterial under the "harmless error" standard

Debtor cites a 1985 case, *Miramar Hotel Corp. v. Frank B. Hall & Co.*, 163 Cal. App. 3d 1126 (Cal. Ct. App. 1985), for the proposition that any court that enters judgment without a signed written statement of decision when one is timely requested commits per se reversible error. Adv. dkt. 41, p.7:9-13. But a subsequent decision by the California Supreme Court holds that a failure issue written statement of decision is subject to harmless error review. *See F.P. v. Monier*, 405 P.3d 1076, 1108 (Cal. 2017) ("… we agree with the Court of Appeal that a trial court's error in failing to issue a requested statement of decision is not reversible per se, but is subject to harmless error review."). The California Supreme Court further explained that the California Constitution, Article VI, Section 13 generally "prohibits a reviewing court from setting aside a judgment due to trial court error unless it finds the error prejudicial," and the section applies to both constitutional and nonconstitutional errors. *Id.* (internal quotation and citation omitted, emphasis added).

In this case the State Trial Court issued an extensive oral statement of decision, and directed Plaintiffs to prepare the written statement of decision. Adv. dkt. 36, p.8:24-25. Plaintiffs did so, and they essentially parroted the State Trial Court's oral statement of decision. None of the defendants, including Debtor, objected to Plaintiffs' proposed written statement of decision. Adv. dkt. 36, p.11:26-27. Nevertheless, the State Trial Court did not sign the proposed written version of its statement of decision.

Debtor filed his notice of appeal without having brought the omission in the statement of decision to the State Trial Court's attention. The State Appeals Court noted in a footnote that no statement of decision was provided by Debtor or Plaintiffs on

appeal, and that "it is therefore unclear from the appellate record whether a written statement of decision was signed and filed, as contemplated by the trial court." Adv. dkt. 38, Ex. 9, p.8-9 n. 6. The State Appeals Court nevertheless affirmed the State Trial Court's judgment, relying heavily on the findings of fact and conclusions of law recited orally by the State Trial Court. *Id.* at p.25. In other words, the State Appeals Court treated the omission of a signed written statement of decision as harmless error.

Indeed, the State Appeals Court hardly could have done otherwise. As noted above, it would have had to find the absence of a signed statement of decision "prejudicial" (*Monier*, 405 P.3d 1076, 1108), and it is clear from the State Appeals Court's summary that Debtor never pointed to the lack of a signed statement of decision, let alone presented any evidence of prejudice.

In sum, it is clear from the "entire record" in the State Court Case (*Silva*, 190 B.R. 889, 893) that both the State Trial Court and the State Appeals Court relied on the oral statement of decision, and that Debtor neither requested nor was entitled to any signed written statement of decision. Alternatively, even if one were required, its absence was a worst harmless error.

(ii) Debtor has waived and forfeited any argument that a signed written statement of decision was required

Plaintiffs argue that Debtor has waived any argument that the judgment is void and the statement of decision cannot be relied upon by failing to raise the issue with the State Trial Court or the State Appeals Court. Adv. dkt. 43, p.4:16-18. This Bankruptcy Court agrees, and in addition finds that Debtor has forfeited that argument. As the Supreme Court has stated, "forfeiture is the failure to make the timely assertion of a right [;] waiver is the 'intentional relinquishment or abandonment of a known right.'" *Hamer v. Neighborhood Hous. Servs. of Chicago*, 138 S.Ct. 13, 17 n.1 (2017) (internal quotation and citation omitted).

At the above captioned hearing, Debtor cited *McCurter v. Older* for the proposition that failure to object to a proposed statement of decision does not constitute

waiver. *McCurter v. Older*, 219 Cal. Rptr. 104, 111 (Cal. Ct. App. 1985). But in a later case the California Supreme Court disapproved of *McCurter*, finding that it did not "discuss[] or even cite[] [Cal. C.C.P.] section 634, which provides for just such a waiver." *In re Marriage of Arceneaux*, 800 P.2d 1227, 1231 (Cal. 1990).[2] The California Supreme Court further found that *McCurter* and similar cases relied on earlier cases that "were decided at a time when [Cal. C.C.P.] section 632 required findings of facts and conclusion of law to be made unless waived," which is no longer the case. *Arceneaux*, 800 P.2d at 1231. The California Supreme Court added that to the extent *McCurter* and the other cited cases "can be read to hold that a party who fails to bring to the attention of the trial court an omission or ambiguity in its statement of decision may nevertheless avoid the presumptions in favor of the judgment, they are disapproved." *Id.* Finally, a litigant who fails to bring omissions or ambiguities in a statement of decision to the attention of the trial court waives the right to assert those errors on appeal, and "the appellate court will imply findings to support the judgment." *Id.*, 800 P.2d at 1228-29.

c. The State Court's findings are not subject to any genuine dispute

Debtor's statement of genuine issues (adv. dkt. 42) either does not dispute Plaintiffs' factual assertions (with minor exceptions such as correcting dates) or does so on the basis that the State Trial Court's oral statement of decision does not constitute valid findings. For the reasons discussed above, Debtor's objections are without merit. Therefore, the State Trial Court's findings, as established in its oral statement of decision and as summarized in the State Appeals Court's decision, are preclusive and not subject to any genuine dispute.

[2] Cal. C.C.P. § 634 provides in relevant part

> When a statement of decision … is ambiguous and the record shows that the ambiguity was brought to the attention of the trial court either prior to entry of judgment or in conjunction with a motion under Section 657 or 663, it shall not be inferred on appeal or upon a motion under Section 657 or 663 that the trial court decided in favor of the prevailing party as to those facts or on that issue." [Cal. C.C.P. § 634]

d. Issue preclusion applies to establish nondischargeability

(i) Issue preclusion applies to establish nondischargeability under § 523(a)(2)(A)

Section 523(a)(2)(A) excepts from discharge any debt "to the extent obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." The Court of Appeals for the Ninth Circuit has held that "a finding of debt due to fraud is *all* that is necessary to satisfy § 523(a)(2)(A) … the receipt of a benefit is no longer an element of fraud under § 523(a)(2)(A)." *Muegler v. Bening*, 413 F.3d 980, 983-84 (9th Cir. 2005) (emphasis in original). In order to prevail under § 523(a)(2)(A), the moving party must satisfy the following five elements by a preponderance of the evidence:

> (1) misrepresentation, fraudulent omission or deceptive conduct by the debtor; (2) knowledge of the falsity or deceptiveness of his statement or conduct; (3) an intent to deceive; (4) justifiable reliance by the creditor on the debtor's statement or conduct; and (5) damage to the creditor proximately caused by its reliance on the debtor's statement or conduct. [*In re Slyman*, 234 F.3d 1081, 1085 (9th Cir. 2000) (internal citation omitted); *See also In re Lee*, 335 B.R. 130,136 (9th Cir. BAP 2005). *See also Husky Int'l Elec., Inc. v. Ritz,* 136 S.Ct. 1581 (2016) ("actual fraud" includes traditional fraudulent schemes, such as fraudulent conveyances, even if misrepresentation is absent).]

The elements of fraud under California law and under § 523(a)(2)(A) are the same. *In re Younie*, 211 B.R. 367, 373 (9th Cir. BAP 1997), *aff'd*, 163 F.3d 609 (9th Cir. 1998); *In re Lee*, 335 B.R. 130 at 136 (citing *In re Younie*).

(A) Identical issue

First, in order for collateral estoppel to apply, "the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding." *In re Harmon*, 250 F.3d 1240 at 1245.

Here, the State Trial Court found that on their first cause of action, fraudulent misrepresentation, Plaintiffs' "met their burden by clear and convincing evidence of fraud and malice. This is clearly a case of fraud and malice. These people were tricked by a lawyer …." Adv. dkt. 38, Ex. D at p.995:25-27 (emphasis added). As to Plaintiff's

eighth cause of action, fraud, the State Trial Court found that "this is an extraordinarily clear case of fraud, of taking advantage of the legal system and using one's bar license to defraud members of the public." *Id.* at 1002:27-1003:1 (emphasis added). The State Trial Court found that Plaintiffs had met their burden of proof by "clear and convincing evidence" and also found "malice, fraud, and oppression and entitlement to punitive damages." Adv. dkt. 38, Ex. D at 1003:15-24 (emphasis added).

In other words, the State Trial Court made multiple findings of fraud. Because fraud under California law mirrors that under § 523(a)(2)(A), this element is met.

(B) Actually litigated

Second, the "issue must have been actually litigated in the former proceeding." *Harmon*, 250 F.3d 1240, at 1245. Under California law, in order for a court to conclude that the issue had been actually litigated in the prior proceeding, it must either find that the state court made an express finding on the issue, or the court must conclude that the issue was necessarily decided in the prior proceeding. *Id.* at 1248-49. An issue is "actually litigated" when "the parties each presented evidence and witnesses in support of their positions, and … had the opportunity to present full cases." *Lucido v. Superior Court*, 795 P.2d 1223, 1225 (Cal. 1990).

Here, Debtor appeared in the State Court Suit, represented himself, and filed an answer to Plaintiffs' first amended complaint. Adv. dkt. 42, p.3, para.4. Further, Debtor participated in discovery and testified at his deposition, and again at trial. *Id.*

Therefore, the issue of fraud was actually litigated because Debtor participated in the proceedings before the State Trial Court. This element is met.

(C) Necessarily decided

Third, the issue "must have been necessarily decided in the former proceeding." *Harmon*, 250 F.3d 1240, at 1245. This element has been interpreted to mean that "the issue not have been 'entirely unnecessary' to the judgment in the initial proceeding." *Lucido*, 795 P.2d 1223 at 1226 (internal quotation and citation omitted); *see also*

Castillo v. City of Los Angeles, 92 Cal. App. 4th 477, 482 (Cal. Ct. App. 2001) (citing *Lucido*).

Here, the State Trial Court found in Plaintiff's favor on their cause of action for fraud (adv. dkt. 38, Ex. D at p.1003), and made the other numerous findings of fraud summarized above. Therefore, the elements of whether Debtor committed fraud were necessarily decided in the State Court Suit. This element is met.

(D) Final and on the merits

Fourth, "the decision in the former proceeding must be final and on the merits." *Harmon*, 250 F.3d 1240, at 1245. A decision is "final" when it is free from direct attack. *Lucido*, 795 P.2d 1223, at 1225.

Here, the State Trial Court entered its judgment after a trial on the merits, the State Appeals Court affirmed, and that decision has become final. Therefore this element is met.

(E) Same parties

Fifth, "the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding." *Harmon*, 250 F.3d 1240, at 1245

Here, Debtor is the same party to both this adversary proceeding and the State Court Suit. Adv. dkt. 39, p.6 para. 12. Therefore this element is met.

(F) Policy

Lastly, if the above five elements are met, California courts will only apply issue preclusion "if application of preclusion furthers the public policies underlying the doctrine." *Harmon*, 250 F.3d 1240, at 1245. These policies are "preservation of the integrity of the judicial system, promotion of judicial economy, and protection of litigants from harassment by vexatious litigation." *Lucido*, 795 P.2d 1223 at 1227. These policies all favor applying issue preclusion, rather than forcing Plaintiffs to re-litigate the fraud issues on which the State Court so clearly and extensively found in Plaintiffs' favor after a trial on the merits.

Therefore, this last element weighs in favor of applying issue preclusion.

(G) Conclusion as to § 523(a)(2)(A)

Because all of the elements of issue preclusion have been met as to fraud under § 523(a)(2)(A), the State Trial Court's judgment against Debtor in favor of Plaintiffs as to fraud is nondischargeable pursuant to § 523(a)(2)(A).

(ii) Issue preclusion does *not* apply to establish nondischargeability under § 523(a)(4)

Section 523(a)(4) excepts from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity …." "'Fraud' under this statute means actual fraud." *In re Roussos*, 251 B.R. 86, 92 (9th Cir. BAP 2000). "Defalcation" means a "failure to fully account for money received in trust" (*In re Sherman,* 658 F.3d 1009, 1017 (9th Cir. 2011) combined with a "culpable state of mind" that involves "knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior." *Bullock v. BankChampaign, NA,* 133 S.Ct. 1754, 1757, 1759 (2013) (overruling *Sherman* on scienter issue only). The term "fiduciary capacity" under this section is a question of federal law, but the Ninth Circuit has considered state law to determine whether the required trust relationship exists. *In re Cantrell*, 329 F.3d 1119, 1125 (9th Cir. 2003). "The fiduciary relationship must be one arising from **an express or technical trust** that was imposed before and without reference to the wrongdoing that caused the debt." *Id.* (emphasis added) (citing *In re Lewis*, 97 F.3d 1182, 1185 (9th Cir. 1996); *Double Bogey, L.P. v. Enea*, 794 F.3d 1047, 1050 (9th Cir. 2015)).

An express or technical trust is generally created by an agreement between parties to impose a trust relationship. *In re Stanifer*, 236 B.R. 709, 714 (9th Cir. BAP 1999). The general characteristics of an express or technical trust are: "(1) sufficient words to create a trust; (2) a definite subject; and (3) a certain and ascertained object or res." *Id.*

Under California law, a technical trust is described as "those arising from the relation of attorney, executor, or guardian, and not to debts due by a bankrupt in the character of an agent, factor, commission, merchant, and the like." *In re Honkanen*, 446

B.R. 373, 379 n.7 (9th Cir. BAP 2011) (internal quotation and citation omitted, emphasis added). Nevertheless, as a matter of **federal** law, the broad fiduciary relationship between an attorney and a client generally is **not** sufficient to establish a fiduciary relationship under § 523(a)(4). *In re Bigelow*, 271 B.R. 178, at 187 (9th Cir. BAP 2001). "In the Ninth Circuit, a general fiduciary attorney-client relationship may rise to the level of a fiduciary relationship for purposes of § 523(a)(4) if there are client trust funds involved." *Id.* (citing *In re Banks*, 263 F.3d 862, 871 (9th Cir. 2001)).

Plaintiffs have not established that trust funds are involved, or that any other express or technical trust was created. Accordingly, this Bankruptcy Court is not persuaded to grant the MSJ with respect to Plaintiffs' claim under § 523(a)(4).

(iii) Issue preclusion applies to establish nondischargeability under § 523(a)(6)

Section 523(a)(6) excepts from discharge a debt resulting from a "willful and malicious injury" by the debtor. On the one hand, "a jury award of punitive damages based on action with oppression or malice is insufficient, standing alone, to support non-dischargeability under 523(a)(6)." *In re Derebery*, 324 B.R. 249, 351 (Bankr. C.D. Cal. 2005) (emphasis added). The fact finder must have made a finding of the debtor's intent to cause injury in order for the imposition of punitive damages to support non-dischargeability. *In re Plyam*, 530 B.R. 456 at 470. On the other hand, of California's four statutory bases for imposing punitive damages "only intentional malice … and fraud expressly require an intent to cause injury," so when a State Court award of punitive damages is based on a finding of fraud, that "satisf[ies] the § 526(a)(6) willfulness requirement for the purposes of issue preclusion." *See also In re Sangha*, 597 B.R. 902, 911 (Bankr. C.D. Cal. 2019).

Put differently, "[t]he legal issue determined by a California court in granting an award of punitive damages for fraud is the same presented to a bankruptcy court in a nondischargeability action under § 523(a)(6)." *In re Molina*, 228 B.R. 248, 252 (9th Cir. BAP 1998) (emphasis added).

(A) Identical issue

Here, the State Trial Court found that on their first cause of action, fraudulent misrepresentation, Plaintiffs' "met their burden by clear and convincing evidence of fraud and malice. This is clearly a case of fraud and malice. These people were tricked by a lawyer and lawyer's agents, who should know better; by these individuals who tricked them into believing they were getting quality legal representation …" Dkt. 38, Ex. D at p.995:25-996:2. The State Trial Court found the imposition of punitive damages appropriate. *Id.* at p.996:9. As to Plaintiff's eighth cause of action, for fraud, the State Trial Court found that "this is an extraordinarily clear case of fraud, of taking advantage of the legal system and using one's bar license to defraud members of the public." *Id.* at 1002:27-1003:1. The State Trial Court found that Plaintiff's had met their burden of proof by "clear and convincing evidence" and also found "malice, fraud, and oppression and entitlement to punitive damages." *Id.* at 1003:15-24.

Therefore, because the State Trial Court imposed punitive damages for fraud, this element is met.

(B) Actually litigated

For the reasons set forth Section 3(d)(i)(B) of this Memorandum Decision, above, this element is met.

(C) Necessarily decided

For the reasons set forth Section 3(d)(i)(C) of this Memorandum Decision, above, this element is met.

(D) Final and on the merits

For the reasons set forth Section 3(d)(i)(D) of this Memorandum Decision, above, this element is met.

(E) Same parties

For the reasons set forth Section 3(d)(i)(E) of this Memorandum Decision, above, this element is met.

(F) Policy

For the reasons set forth Section 3(d)(i)(B) of this Memorandum Decision, above, this element is met.

(G) Conclusion as to § 523(a)(6)

Because all of the elements of issue preclusion have been met as to a willful and malicious injury under § 523(a)(6), the judgment against Debtor in favor of Plaintiffs as to fraud is nondischargeable pursuant to § 523(a)(6).

4. CONCLUSION

For the reasons set forth above, the State Trial Court's judgment against Debtor in favor of Plaintiffs as to fraud, and for punitive damages, is nondischargeable pursuant to Sections 523(a)(2)(A) and (a)(6). Plaintiffs are directed to lodge a proposed nondischargeability judgment within seven days after entry of this Memorandum Decision on the docket.

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Date: November 12, 2019

Neil W. Bason
United States Bankruptcy Judge